Macquarie Group Limited
ABN 94 122 169 279

No.1 Martin Place
Sydney NSW 2000
GPO Box 4294
Sydney NSW 1164
AUSTRALIA

Telephone (61 2) 8232 3333
Facsimile (61 2) 8232 7780
Internet http://www.macquarie.com.au

15 March 2013

The Manager
Corporate Reporting and Accountability Unit
Corporate and Capital Markets Division
Australian Treasury
Langton Crescent
PARKES ACT 2600

By email to: corporatereportingreforms@treasury.gov.au

CONFIDENTIAL

Dear Sir/Madam

Proposed amendments to section 254T of Corporations Act (Dividend Test)

This submission is made by Macquarie Group Limited and its subsidiaries (Macquarie) in response to the exposure draft of the Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012, which was released by the Parliamentary Secretary to the Treasurer on 14 December 2012 (Exposure Draft). This submission follows our previous submission dated 30 January 2012 on the discussion paper proposing options for reform of the Dividend Test which was released by the Parliamentary Secretary to the Treasurer on 14 December 2012 (Discussion Paper).

We principally wish to address available refinements to the proposed new Dividend Test which would more closely align it with the New Zealand law on which it is based, and reduce the administrative impact and areas of uncertainty concerning the proposed new Dividend Test. However, we also wish to comment on the proposed interaction between section 254T and Part 2J.

Overview of our submissions

(a) Reinstatement of the profits test.

We note the draft Explanatory Memorandum in relation to the Exposure Draft states:

> The new dividends test does not displace the existing requirements in relation to conducting share capital reductions and share buy-backs under Part 2J of the Corporations Act. These provisions will continue to apply under the new dividends test.

This contrasts with the previous statement in the Discussion Paper that:

> The Treasury considers that the test for paying a dividend in section 254T of the Act is a circumstance where a reduction in capital is 'otherwise authorised' by the law. ... The Treasury believes the legislative provisions are clear. However, the concern raised by some stakeholders suggests that there may be merit in either amending the

legislation or inserting a note to clarify the inter-relationship between the operation of the dividends test and the capital maintenance provisions.

In our view, Treasury's latest position on this issue is difficult to reconcile with the Government's stated intentions when it originally replaced the old "profits test" in the former section 254T. In substance, the practical effect of the proposed assets and liabilities test and the maintenance of Part 2J will be to reinstate the profits test because any dividend not paid out of profits will be subject to the rules governing capital reductions.

We would like to reiterate our previously expressed view that section 254T should be an exception to the capital reduction provisions in Part 2J.1 of the Corporations Act but not the insolvent trading provisions, which would make it consistent with the Government's original stated intentions.

(b) The solvency test.

Leaving the above issue aside, Macquarie welcomes Treasury's response to market concerns about the detailed operation of the current Dividends Test and we continue to support a sole solvency-based test. However, there are key elements of the New Zealand approach which Macquarie submits also should be included in the proposed Dividend Test.

These are:

1. In determining whether the New Zealand solvency test is satisfied, when valuing assets and liabilities directors may give consideration to all the circumstances which may affect the value of the company's assets and liabilities. In this regard directors may rely on current valuations of assets or estimates of liabilities that are reasonable in the circumstances (section 4 of the Companies Act 1933 (Companies Act).
2. The New Zealand test makes it clear that directors are required to determine whether the solvency test is met at the time they resolve to fix the amount and time for payment of the dividend (Companies Act, section 52(1)).
3. The New Zealand test includes an explicit direction that (absent an express authorisation in the company's constitution) a company's liabilities for the purpose of the test include any amount that would be needed, if the company were to be dissolved at the time of the dividend payment, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution (Companies Act, section 52(4)).

1. Valuing assets and liabilities

As we expressed in our previous submission, flexibility for directors to apply their judgement in determining the most appropriate valuation of assets or estimate of liabilities will reduce the likelihood of unintended consequences for shareholders. In applying the New Zealand test, directors must have regard to:

(i) the company's most recent financial statements which complied with the New Zealand Financial Reporting Act 1993 – which mandates compliance with accounting standards; and

(ii) all other circumstances that the directors know or ought to know affect, or may affect, the value of the company's assets and the value of the company's liabilities, including its contingent liabilities,

(Companies Act, section 4(1)).

The benefit of this approach for companies, directors and shareholders, is that a link to accounting standards can still be maintained whilst providing directors with the flexibility to determine potentially more appropriate (including prudent) valuations which may otherwise not be permitted under accounting standards such as:

- provisions for loan losses based on market deteriorations;

- current valuations of assets that are carried at historical cost for accounting purposes; and
- adjustments for fair value accounting mismatches (e.g. where hedge accounting is not available despite the entity economically hedging the relevant exposures).

As we noted in our previous submission, there are other international precents for these elements of the New Zealand approach, including Canada and the United States. We do not agree that the absence of an express link to the accounting standards in the New Zealand test is a disadvantage of adopting that approach.

By requiring directors to have regard to the most recent financial statements (prepared in accordance with accounting standards, if applicable), a revised Dividend Test in line with section 4(1) of the Companies Act would provide greater clarity and certainty to the decision making process than proposed section 254T(4), particularly if there is discretion for directors to have regard to valuations of assets or estimates of liabilities that are reasonable in the circumstances. Protection of shareholders and creditors would be further bolstered by directors' current duties of care, diligence and good faith under sections 180 and 181 and the penalties for breach of these duties. These provisions set a high standard for director conduct which provides protection for shareholders and creditors against misapplication of appropriate valuations.

2. Applying the Dividend Test to dividends without a declaration

We support the revision of section 254T to include express provision for dividends which are approved by directors without making a declaration. However, the proposed drafting of subsection 254T(2) presents a procedural inconsistency with proposed subsection (1). The latter accommodates a sensible timeline for the payment of a dividend where the board of directors need apply the Dividend Test once only, at the time it makes the dividend declaration. In contrast, subsection (2) can be read as obligating the board to apply the Dividend Test twice, in the typical process under which Australian listed companies pay dividends.

Listed companies are required by the ASX Listing Rules to announce the details of a dividend at least 8 business days before they pay the dividend. This is because the record date for a dividend must be at least 7 business days after the announcement and the payment date must occur after the record date (ASX Listing Rules Appendix 6A). The typical period between announcement and payment is significantly longer to allow share registries to undertake the necessary processing and a period of several weeks between announcement and payment is common. In these circumstances, proposed subsection 254T(2) can be read (in conjunction with subsection (4) and the ASX Listing Rules) to require the board to make a formal determination on the Dividend test immediately before the announcement *and then again* immediately before payment.

Again we submit that the New Zealand approach is our benchmark of current best practice on this topic. Section 52(1) of the Companies Act makes it clear that the New Zealand dividend test is to be conducted at the time the directors resolve to approve the proposed dividend. Consistent with ASX Listing Rules, this would occur immediately prior to the announcement of the dividend. The New Zealand provisions contemplate that circumstances may change. However, rather than effectively requiring directors to repeat the exercise of approving the dividend, the New Zealand provisions state that:

> "*(i)f, after a distribution is authorised and before it is made, the board ceases to be satisfied on reasonable grounds that the company will, immediately after the distribution is made, satisfy the solvency test, any distribution made by the company is deemed not to have been authorised*" (Companies Act, section 52(3)).

We submit that the proposed section 254T(2) should be amended to read "A company must not pay a divided unless at the time the directors of the company determine that the dividend

is payable…". A similar change should also be made to the table in section 588G(1A) if alignment between section 254T and section 588G91A) is considered paramount.

We also submit that subsection 254T(1) and (2) should be qualified by a prohibition against payment based on section 52(3) of the Companies Act.

A requirement that boards continue to monitor company performance in the lead up to the dividend payment is preferable to an obligation to effectively conduct the Dividend Test twice. This is not merely a procedural nicety. It is a case of avoiding unnecessary administrative burden on boards.

The Explanatory Memorandum to the Exposure Draft ("EM") states that the timing of the new Dividends Test aligns with Corporations Act provisions on when liabilities are incurred. We submit that the key is not to align the timing of the board's deliberation with the date a debt arises; rather the key is to dissuade boards from approving and announcing dividends that are imprudent or unlawful. Moreover, the New Zealand approach would provide sufficient alignment without necessitating repeated application of the Dividend Test absent any reasonable concern on the part of directors about the solvency of the company after the dividend is paid.

We note that in April 2012, the governments of Australia and New Zealand have asked the Productivity Commissions of each country to conduct a study on strengthening trans-Tasman economic relations. Differences in legislation between our two countries, such as the requirements for paying dividends, increases the barriers. So it would seem Treasury's proposals are inconsistent with the intended strategic direction of the government.

3. Adjusting for preferred rights on company dissolution

We submit that the new Dividends Test should include an explicit direction that (absent an express authorisation in the company's constitution) a company's liabilities for the purpose of the test include any amount that would be needed, if the company were to be dissolved at the time of the dividend payment, to satisfy the preferential rights upon dissolution of shareholders whose distribution rights are superior to those receiving the dividend. Companies Act, section 52(4) includes this direction. We submit that this direction would provide clarity for directors and greater protection of the rights of holders of preference shares and other preferred securities.

4. General law implications

We note that dividend rules are also subject to the general law. In practice, companies and their directors will need to have regard to the general law rules, as amended by section 254T.

We submit that the general law approach to prior year losses be maintained. Under this approach a trading loss made in a previous accounting period does not have to be made good when determining the profit made in the most recently concluded trading period: *Ammonia Soda Company Ltd v Chamberlain;* [1918] 1 Ch 266 at 283; [1916–17] All ER Rep 708; *Marra Developments Ltd v BW Rofe Pty Ltd* [1977] 2 NSWLR 616 at 630; *Spassked Pty Ltd v Cmr of Taxation* (2003) 203 ALR 515.

This should be made clear in the Explanatory Memorandum.

Yours sincerely

[Signed: by email]

Patrick Upfold
Chief Financial Officer
Macquarie Group Limited